NOTES

THE WAR AND THE INTERNATIONAL MERCANTILE MARINE COMPANY

The European war has brought to some enterprises changes sufficiently important to bridge the chasm between bankruptcy and prosperity. Those concerns that have been actively engaged in meeting the demands of the belligerents for military supplies—food, clothing, arms, and ammunition—have felt the direct impetus afforded by the contest, while business generally is flushed with the activity that the situation has produced.

In few other fields has the effect of the war trade been more remarkably shown than in that of shipping and ship-building. Shortly after the declaration of war, those nations who still enjoyed the freedom of the seas began giving orders to American manufacturers for immense quantities of supplies. At the same time they requisitioned a large part of the tonnage of the vessels chartered under their flags for the purpose of transporting troops to distant scenes of operations, as well as for the provisioning of these troops. This extraordinary demand upon shipping facilities, coupled with the contemporary reduction in the total available tonnage occasioned by the internment of German and Austrian boats, opened a tremendously enlarged field of operations for those vessels which remained in the trans-Atlantic trade.

One of the companies thus fortunately situated is the International Mercantile Marine Company. Before the outbreak of the war it had become evident that a drastic reorganization would be necessary to enable it to compete with the Cunard Line and the two German companies—the Hamburg American and the North German Lloyd. The accumulated and unpaid dividends upon its preferred stock amounted to approximately three-fourths of the preferred stock's par value, and the company had been placed in the hands of a receiver because of its failure to meet interest falling due on its funded debts.

As was noted in an article by the present writer published in November, 1915,[1] the large profits that had already begun to result from the war trade had brought to the stockholders the realization that the plan

[1] *Journal of Political Economy*, XXIII, 910–25.

of reorganization dated August 3, 1915, which had been proposed by the bondholders' committee, would, if adopted, be unfavorable to their interests. As a consequence two committees were organized to represent the interests of the preferred and common stockholders, respectively. Hitherto, the interests of both classes of stockholders had been represented by the De Forest Committee. Under the new arrangement, the interests of the preferred stockholders were taken up by the Wallace Committee, organized in September, 1915, James N. Wallace, chairman; while the interests of the common stockholders were taken up by the Platten Committee, organized in November, 1915, John W. Platten, chairman. These committees, by advertisements, requested the deposit of preferred and common stocks, respectively, and began an active campaign against the foreclosure proceedings which were being pressed by the Bannard Committee, representing the bondholders.

To present any kind of formidable front to the contentions of the bondholders' committee, it was first necessary for the preferred stockholders' committee to put experts to work to obtain necessary data upon which to base their claims to more consideration than the plan of reorganization submitted by the bondholders' committee accorded them. This plan, dated August 3, 1915, deprived the stockholders of most of their interest in the company, for, had it gone into effect, the preferred stockholders would have received 20 per cent of the par value of their shares, in new common stock, while the common stockholders would have received only 5 per cent of the par of their shares, in new common stock. Only the old bondholders were assigned allotments of new preferred stock. This plan was declared operative, and shares of the new stock were bought and sold on a "when issued" basis. However, the determined opposition of the preferred stockholders' committee, later supported by that of the common stockholders, led to successive postponements of the foreclosure decree and to the final abandonment of the bondholders' committee's plan.

The accountants employed by the preferred stockholders' committee submitted their preliminary report in September, 1915, in which they made important allegations regarding the finances of the company, viz., that for the first seven months of the year 1915 the earnings of the company were extraordinarily large—over $11,000,000, apart from allowances for depreciation and war tax, but exclusive also of the undivided earnings of certain subsidiaries. In addition, the International Mercantile Marine Company's proportion of the earnings of the Leyland Line, in which it has a large interest, was over $7,000,000 for that period.

Such earnings, in comparison with those of earlier years, were indeed flattering. If, as a result—and this claim was now advanced—the company had been in a position during the entire month of March, 1915, to pay all interest, both current and in arrears, on its outstanding bonded indebtedness, then the stockholders would be able to make out a pretty good case against the threatening foreclosure; for it was not until March 31, 1915, that the six month's period of grace expired, in which the default in interest on the $4\frac{1}{2}$ per cent bonds could be remedied. The amount of cash on deposit to the credit of the company on March 31 was, according to the expert accountants, $8,538,394. It was furthermore claimed that information to that effect was in the possession of the board of directors sufficiently early to permit them to act accordingly.

Owing to the bad general financial condition of the company in the early part of 1915, it may be seriously questioned whether the presence of over $8,000,000 in the coffers of the company would have justified staying the decree of foreclosure. But since the continuously improving condition of the company encouraged the stockholders to protest vigorously against the decree, it became increasingly evident that it would be necessary to formulate another plan more favorable to their interests. As late as October 14, 1915, however, the bondholders' committee announced that "we will go ahead to obtain foreclosure decrees on the Company's two defaulted bond issues, and we have been advised by counsel to stick to the middle of the road."[1]

The common and preferred stockholders' committees were of one mind in opposing the foreclosure decree, but as prospects grew better for a settlement without foreclosure, they mutually disagreed upon the benefits which should accrue to the two classes of stock from some alternative arrangement.

In December, 1915, the preferred stock committee announced that 66 per cent of the preferred stock had been deposited; and the common stockholders' committee had begun an investigation of the company's affairs on its own account, and urged the deposit of all common stock.[2] Meanwhile there occurred a still further postponement of the foreclosure proceedings, and both the stock committees extended the time for the deposit of their respective stocks. In January the Platten committee announced that a majority of the common stock had been deposited, and again extended the time for making further deposits of the stock. In the latter part of January the Wallace committee made further proposals

[1] *Commercial and Financial Chronicle*, CI, 1275.

[2] *Ibid.*, p. 1977.

to the common stockholders' committee, which the latter rejected. In February announcement was made that, owing to the inability of the two stockholders' committees to agree, the preferred stockholders' committee would proceed independently to formulate a plan for the retirement of the bonds.

Thus, for months the interested parties marked time while attempting to find some plan sufficiently favorable to all to permit some sort of unified action. The bondholders seemed willing to let matters rest temporarily, since their position could not be weakened in the face of the abnormally large profits accruing from war business. The respective positions of the two stockholders' committees, which resulted in this deadlock, were as follows:

The preferred stockholders' committee was originally formed to prevent what it deemed would be the "practical extinction" of its interest in the International Mercantile Marine Company. Fortified by the deposit of over 83 per cent of the preferred stock and by the results of its investigation, it now wished to promulgate a plan for the refunding of the existing bonded indebtedness. But, in doing so, it came into conflict with the common stock committee, which made demands in excess of anything the preferred stock committee felt to be equitable. The preferred stock committee stated its intention of proceeding at once to the solution of the legal questions involved in the foreclosure. Should this result in disclosing that the bonds were not due, the committee felt that the company's large earnings would make likely an early payment on account of the accumulated dividends, which on August 1, 1916, amounted to 82 per cent of the par value of the preferred stock. In the contrary case of foreclosure, the committee felt that it would be able to acquire the properties in the interest of the preferred stockholders.

The common stock committee objected to the small place accorded it by the preferred stock committee in any of the proposed plans of reorganization, which amounted to about a one-ninth interest. This committee firmly asserted that the proper course was first the payment of the debt and the restoration of the property to the company. Then would follow sufficient time to make adjustments between the two classes of stock. The reader should bear in mind this contention of the common stockholders' committee because of its similarity to the arrangement finally consummated. For a time the preferred stock committee favored a reduction of the indebtedness, and in this they were supported by the common stock committee, which adhered to this policy after its abandonment by the preferred stock committee. Evi-

dently the change in the attitude of the preferred stock committee was due to its desire to make a payment on the accumulated dividends on the preferred stock. No doubt the attitude of the common stockholders was the safer and more conservative one.

As events unfolded, the undesirability of foreclosure grew increasingly evident. "The course to be pursued," says the statement of the common stock committee, "seems clear, namely, to reduce the debt to a point at which it ceases to be a menace to all security holders and leave the two classes of stock undisturbed." Throughout the company's history heavy fixed charges, occasioned chiefly by the large bonded indebtedness, had placed upon the company's treasury an ever-increasing burden, the effect of which would have been inevitable bankruptcy but for the fortuitous event of war. To use the large accumulation of cash for any other purpose than the reduction of the long-standing menace of an excessive bond indebtedness would be extremely unwise. Although the contention of the common stockholders was entirely proper from the financial standpoint, it was no doubt advocated as a measure of self-interest. Foreclosure would probably have meant the annihilation of the common stock equity or, at any rate, its reduction to a position of insignificance in the process of scaling down. The position of the common stockholders' committee may be summarized briefly thus:

1. In the presence of the large war profits foreclosure was no longer the proper remedy.

2. Cash on hand should be used exclusively for the reduction of the debt.

3. Adjustments between the common and preferred stockholders must be conditioned on such reduction of the debt.

As the committees were unable to meet on these propositions, negotiations were broken off on February 7, 1916. It then appeared that foreclosure proceedings must finally settle the matter. Fortunately, less drastic measures were adopted.

Before coming to the solution ultimately effected, let us consider briefly the basis of the financial position of the company. Its capitalization was divided between bonds and stock as follows:

Bonds, two issues, $4\frac{1}{2}$ per cent and 5 per cent..	$70,226,000
Preferred stock, par value....................	51,725,720
Common stock, par value....................	49,872,110

The annual interest on the bonds amounted to $3,248, 300, and on July 1, 1916, the amount of interest in arrears would reach a total of $7,014,876.50. Upon the preferred stock the dividends in arrears

amounted to 78 per cent of its par value. The International Mercantile Marine Company owned the subsidiary White Star, Dominion, Atlantic Transport, American, and Red Star lines, which, on December 31, 1914, had in service vessels possessing an aggregate tonnage of 800,000 and also had something over 220,000 tons under construction, approximately one-half paid for. The foregoing companies were owned directly or through a 100 per cent stock ownership. In addition, the company owned 98½ per cent of the common stock and most of the preferred stock of the Leyland Line, which on December 31, 1914, had in service nearly 289,000 tons and somewhat over 15,000 tons under construction. The International Mercantile Marine Company also held the following investments, directly or through its subsidiaries:

Company	Percentage of the Company's Securities Owned by the I. M. M. Co.	Tonnage of Vessels	
		Operated	Under Construction
Holland-America Line	25	220,517	34,000
Shaw-Savill & Albion Co., Ltd.*	44	78,488	16,250
George Thompson Co., Ltd	30	41,819	*8,000

* Approximate

Further description of the assets is unnecessary here, nor would it be profitable to attempt a valuation of these properties upon the basis either of original cost or of present earning power. In the former article, already cited,[1] the writer indicated the probable excessive valuation placed on some of the subsidiaries at the time of the purchase. The earnings of such a company fluctuate so much that any attempt to give to its assets any other than a purely empirical value based on profits must prove largely erroneous.

Let us turn, therefore, to a consideration of profits. Until the war opened up new vistas of abnormal prices and an ocean freed from competing German vessels, the actual profits of the company were sometimes tenuous to the point of invisibility. Only by omitting adequate depreciation allowances was the income account padded up to make it appear that sufficient profits had been made to meet fixed charges. But after the brief period of financial chaos that attended the opening of the war, a remarkable change occurred in the earnings of the company. Not long after the organization of the company in 1902, it was predicted by its officials that the net profits would soon amount to over $16,000,000 annually. But such a figure was never even approached until after the war began. Then it was not long before that forecast was belittled

[1] *Journal of Political Economy*, XXIII, 910–25.

by actual profits. In attempting to state definitely just what the war profits have been, we are handicapped by the failure of the stockholders' committees, in their published statements, to make allowance either for depreciation or for the war tax which those subsidiary companies, whose vessels fly the British flag, must pay. However, approximate allowances can be made for these items. Commerce in war materials did not get under way sufficiently to make the remaining five months, August to December of 1914, typical of earnings; but during 1915 the company was as well adjusted as possible to the new conditions, with the result that, after all expenses except depreciation and the war tax were deducted, profits for the year amounted to more than $41,000,000. According to the statement of the common stockholders' committee,[1] the net profits for the seven-year period 1903–9 averaged about $4,900,000 annually, and for the four-year period 1910–13 about $9,400,000, but it may be safely stated that these figures are too large owing to insufficient depreciation allowances. It is difficult to determine the proper deduction for depreciation and war tax for 1915. Using the last three months of 1915 and the first three months of 1916 as a basis, the common stockholders committee estimate war earnings, after deducting all charges, at $36,000,000 annually, or about eightfold the average earnings of the company during the ten years preceding the war. It being impossible to forecast the war's duration, it is equally impossible to estimate the total excess of earnings above normal that will result from the war. It seems safe to assume, however, that the war will not end before the close of the present year, and therefore that the company will add to its capital not less than $60,000,000, which it would not have secured had not the war occurred.

This increase of capital may take one of two forms—increase of assets or decrease of liabilities. A third, but now impossible, alternative would have been the distribution of part of this amount to liquidate the accumulated dividends on the preferred stock, at present amounting to over 82 per cent of the stock's par value.

Proper use of the war profits will aid greatly in resuscitating the company, just as some of our manufacturers will profit by the conservative use of their profits. By the conservative use of such profits is meant their use in the reduction of debts rather than in the payment of large dividends.

On July 6, 1916, J. W. Platten, chairman of the common stockholders' committee, announced that the two committees had agreed upon the "principle" to be pursued in the reorganization of the company.

[1] *Commercial and Financial Chronicle*, CII, 1439.

What this "principle" was may be gleaned from the following extract taken from the statement of the two committees to the stockholders: "The Committees after careful consideration respectively determined that the interests of the Company and of its stockholders of both classes demanded that the existing bonded debt be refinanced at this time when favorable financial conditions prevail," furthermore "leaving the matter of the payment or funding of the accumulated dividends upon the preferred stock to the future action of the board of directors of the Marine Company and to the action of its stockholders should action by them be required." Thus the earlier contention of the common stock interests was essentially adopted.[1] The important features of the new reorganization plan, dated August 1, 1916, and superseding the old one, dated August 3, 1915, are as follows:

The retirement of both the old outstanding bond issues is contemplated. Provision is made for the payment at maturity of such of the two old issues as may be withdrawn or remain undeposited under the bondholders' agreement. For the purpose of refunding these old bonds, $40,000,000 of new first mortgage and collateral trust sinking fund gold bonds are authorized, to bear interest at 6 per cent and redeemable at 110 and interest. To make possible the securing of all cash necessary under the refunding plan, an issue of notes is provided with a maximum limit of $10,000,000. A reservation of $10,000,000 in bonds is also made to meet cost of future extensions. According to the plan the distribution of cash and securities for each of the old $1,000 five per cent bonds is as follows:

a) In new bonds:		
57 per cent of principal amount		$ 570.00
b) In cash:		
43 per cent of principal amount	$430.00	
Unpaid coupons	100.00	
Interest, August 1, 1916, to October 1, 1916	8.33	538.33
Total new bonds and cash		$1,108.33

and for each $1,000 four and one-half per cent bond as follows:

a) In new bonds:		
57 per cent of principal amount		$ 570.00
b) In cash:		
43 per cent of principal amount	$430.00	
Unpaid coupons	112.50	542.50
Total new bonds and cash		$1,112.50

[1] Plan and agreement of reorganization, dated August 1, 1916.

By this partial amortization of the old bond issues, the amount of bonded indebtedness is reduced to slightly over $40,000,000. This material reduction means a large reduction in the fixed charges, and withal must have the effect of placing the company on a sounder financial basis. Annual interest charges before reorganization amounted to $3,248,330. Under the new plan, they will be reduced by an amount ranging from one-quarter to one-half of a million dollars.

The foregoing plan has already been consummated. Notices have been published in the financial columns, requesting holders of certificates of deposit to surrender them and receive in exchange new stock certificates. The International Mercantile Marine Company enters upon a new and apparently a more propitious period. The improved condition of the company is reflected in the marked rise in the price of its stocks. Pre-war prices of both classes of its stocks are shown below:

Period	Common		Preferred	
	High	Low	High	Low
1902–6..........	21	2	50	14 7/8
1907–13........	9	2 7/8	27 5/8	10
1914...........	3 3/4	5/8	51 1/4	3

Contrast with this poor showing the high and low prices for the first nine months of 1916:

	Common		Preferred	
	High	Low	High	Low
January to September, 1916, inclusive	50 7/8 Sept. 14	13 3/8 Feb. 15	125 5/8 Sept. 11	61 1/4 Mar. 1

These figures probably do not accurately reflect the improvement that has occurred in the company's affairs, but they are at least an indication of a rejuvenation that has come quickly and at a time when aid was very badly needed. It is one of those strangely beneficial effects that sometimes result from disaster and calamity.

Earl A. Saliers

Sheffield Scientific School, Yale University